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Limited Merits Review Project Team
C/o COAG Energy Council Secretariat
GPO Box 9839
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Submitted by email to energycouncil@industry.gov.au

Dear Officials

Review of the Limited Merits Review Regime – Consultation Paper

TransGrid welcomes the opportunity to respond to the consultation paper published by the Project Team on 6 September 2016 as part of this review of the limited merits review (LMR) regime.

TransGrid is the operator and manager of the high voltage transmission network connecting electricity generators, distributors and major end users in New South Wales and the Australian Capital Territory. TransGrid's network is also interconnected to Queensland and Victoria, and is instrumental to an electricity system that allows for interstate energy trading.

TransGrid is in the unique position of its ownership having recently transferred from the NSW Government to a consortium of both Australian and international investors. That process involved an injection of $10.3 billion of private debt and equity capital into the electricity network sector, thereby freeing up an equivalent sum for investment by the NSW Government in new, public infrastructure projects.

TransGrid is deeply concerned at the hasty nature of the process that has been established by the COAG Energy Council for this review, and the risk that the consultation paper may create in the minds of some a view that the outcome of this process may have been predetermined.

TransGrid does not accept the explicit premise underpinning the review (which has apparently driven the severely truncated consultation timetable) that decisions on potential reforms to the LMR framework are needed before the end of this year in order *"to increase policy and legislative certainty for the AER, regulated energy businesses and consumers"*.[1]

TransGrid is equally concerned at the manner in which certain matters are set out in the consultation paper, such as its reference to the LMR regime having led to "*network businesses [having] asked the Tribunal to increase their revenue by around $7 billion over a five year period*".[2]

[1] COAG Energy Council's consultation paper, p. 5.
[2] COAG Energy Council's consultation paper, p. 4.

Rather than increase policy and regulatory certainty, the timetable for the review itself and the consultation paper risk having the opposite effect. The expedited timing of the review and the approach taken in the consultation paper risks increasing the degree of uncertainty surrounding a fundamental pillar of the regulatory framework, and will have potentially damaging effects on the perception of Australia as an investment environment with low sovereign risk. This in turn will have material repercussions on both the willingness, and cost, of investors in funding future investment in the sector.

Whilst TransGrid does not see there is a compelling case for substantial reform at this time (thus preferring option 1), TransGrid would be happy to work with the Council and its officials to adequately assess the real issues with the current arrangements and also the benefits and limitations of any changes, including a more detailed assessment of the high level options provided in the consultation paper (option 2). We do not see option 3 as a viable option at this stage although the institutional arrangements for LMR will need to be considered if the Commonwealth proceeds with the institutional reforms suggested by the Harper Review.

TransGrid does not support option 4 set out in the consultation paper to remove LMR. LMR is a central part of most best practice regulatory frameworks as it keeps the regulator accountable, enables the development of the processes underpinning the National Electricity Law, and provides certainty to providers of both debt and equity. It ensures regulators make good decisions the first time and any short-comings in regulatory decisions are addressed promptly. If removed, it would provide regulators with unconstrained discretion with no oversight on the appropriateness of their decisions. We explain the basis for these concerns in the substantial part of this submission attached.

TransGrid urges the Senior Committee of Officials to recommend to Ministers that this review process be extended beyond its presently contemplated early December decision point so as to accommodate a more carefully considered approach to both the nature and extent of any problems with the LMR regime that need to be addressed, and the appropriate policy responses.

If reform to LMR is necessary then the changes being proposed in the Energy Networks Association's submission are worthy of proper consideration.

TransGrid wishes to acknowledge HoustonKemp for their contribution to this submission.

If you would like to discuss any matter raised in this submission, please do not hesitate to contact me on (02) 9284 3300. TransGrid looks forward to engaging further with the Council, Officials and other stakeholders on this important review.

Yours faithfully

Anthony Meehan
Executive General Manager, Business Growth and Revenue

TransGrid Submission

Executive Summary

TransGrid welcomes the opportunity to make this submission to the Senior Committee of Officials (SCO), and thereby contribute to the review of the limited merits review (LMR) regime (the review), as recently instigated by the COAG Energy Council.

TransGrid strongly values the LMR function

The LMR regime is a fundamental pillar of the regulatory framework applying in the energy sector. Investors in TransGrid have committed substantial capital to the electricity network sector, both to acquire the business and to seek opportunities for efficiency enhancement and growth (both within and outside TransGrid's regulated activities), including through the commitment of substantial further capital.

A significant factor in that capital commitment was the existence of a stable, well-functioning regulatory regime, including the option to seek merits review of revenue determinations by the Australian Energy Regulator (AER). It is vital that policy makers remain cognisant of the potential adverse implications for business' credit ratings and the current high standing of the Australian regulatory environment in the eyes of overseas investors of what may be seen as hasty and unnecessary changes.

The fact that – in the context of the first set of applications of significantly revised rules – the parties have identified matters of difference that involve sums as significant as $7 billion underlines the importance of the LMR framework for resolving the ambiguities and or inadequate accountability implied by this sum.

The LMR regime provides an incentive for regulators to make good decisions the first time. It also ensures that any short-comings in regulatory decisions are addressed. Indeed, the LMR process has enabled the correction of material errors in previous AER determinations that the AER itself has agreed to.

Removal of LMR would provide regulators with unconstrained discretion, with no oversight on the appropriateness of their decisions or driver to improve those decisions – this is likely to lead to adverse investment incomes most likely via an increase in the cost of capital. LMR arrangements therefore play a key role in a well-functioning regulatory framework, and are a feature of arrangements throughout other sectors and jurisdictions in Australia, as well as overseas.

Importance of correct problem definition

TransGrid's fundamental proposition to the review is that the LMR function – as amended in 2013 – is operating as intended to secure the stated policy goals, and there is little or no need for material change.

In the current context, a careful review of the circumstances and matters leading to the applications for merits review of AER determinations (by both network businesses and consumer groups) reveals that the 'problem' to be addressed can be characterised as:

- the substantial rule changes made in 2012 which took effect in 2013, introduced significant discretion for the AER in relation to two critical elements of energy network

price/revenue determinations, ie, the allowed rate of return, and the allowance for operating expenditure;

- it should be unsurprising that, in the first application of these new rules, parties would use the LMR function to clarify the principles by which the new rules should be interpreted and applied, so that the initial applications for review represent an inevitable and desirable part of a 'bedding down' process;
- put another way, the development of a body of precedent that was an explicit objective of the post-2013 LMR regime[3] cannot be achieved without the parties first being prepared to invest in seeing through the review of those new elements of the rules;
- the significant, new elements of the LMR function put in place in 2013 – being the need to consider whether there is a materially preferable decision and a presumption of remittal to the AER – are still to be given effect, with the delay in doing so arising through a decision by the AER not to proceed with implementing the February 2016 decision of the Australian Competition Tribunal (the Tribunal); and
- the bulk of the delay and the 'piling-up' of LMR applications arises from the decision by the AER to refer fundamental matters of interpretation made by the Tribunal for legal review by the Full Federal Court – a decision with limited precedent in the operation of either this or any other LMR regime applying in Australia.[4]

The existence of twelve applications for review of decisions by the AER does not establish by itself sufficient evidence that the post-2013 LMR regime is not working effectively. Rather, it reflects:

- the overlapping timing of the AER's regulatory determinations, and the subsequent appeals processes;
- a high degree of commonality of issues across the LMR applications; and
- AER decisions not to accept tribunal determinations.

The commonality of issues across current LMR applications strongly suggests that once the 'roadblock' of the NSW/ACT determinations has been resolved, resolution of the remaining LMR applications should follow reasonably swiftly.

Review process inadequate for changes being contemplated

TransGrid is concerned at the hasty nature of the process that has been established by the COAG Energy Council for this review.

Hasty or ill-considered reforms to the LMR regime have the potential to inflict lasting damage to the perception of Australia as an investment environment with low sovereign risk. Rather than increase policy and regulatory certainty, the timetable for the review itself as well as many of the premises on which the SCO consultation paper proceeds, have had precisely the opposite effect.

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[3] SCER *Regulation Impact Statement, Limits Merits Review of Decision-making in the Electricity and Gas Regulatory Frameworks, Decision Paper*, 6 June 2013, p. 33-34.

[4] The ACCC did previously seek judicial review of a 2004 Tribunal decision relating to the access arrangement for the Moomba to Sydney Pipeline. (Australian Competition & Consumer Commission v Australian Competition Tribunal [2006] FCAFC 83 (2 June 2006)). To TransGrid's knowledge, none of the network businesses have previously sought judicial review of a Tribunal decision.

The review of the LMR arrangements, undertaken by independent experts, in 2012-13 took 15 months in total. It also proceeded in several stages, with four consultation papers plus opportunities to respond to the draft recommendations at each of the three main reporting stages.

In contrast, the current review is scheduled to be completed within four months (with potentially an even shorter effective timetable), is being undertaken by SCO officers and has only one substantive opportunity for stakeholders to provide input.

More generally, adequate consultation requires a significantly more extended timeframe, which incorporates opportunities for stakeholders to review and respond to draft recommendations, as well as to provide their input ahead of the development of those recommendations. This is demonstrated in the standard processes adopted by the Productivity Commission, the Australian Energy Market Commission (AEMC) and for other significant policy reviews, such as the recent Harper Review.

The expedited nature of the process is not conducive to good public policy making – particularly, for an issue of such fundamental importance – with substantial potential repercussions for the availability of capital and so the prices that consumers pay.

A more considered process is therefore warranted

TransGrid urges the SCO to recommend to Ministers that the review process should be extended beyond its presently contemplated early December decision point so as to accommodate a more carefully considered approach to both the nature and extent of any problems with the LMR regime that need to be addressed, and the appropriate policy responses.

TransGrid does not accept the explicit premise underpinning the review (which has apparently driven the severely truncated consultation timetable) that decisions on potential reforms to the LMR framework are needed before the end of this year in order to '*increase policy and legislative certainty for the AER, regulated energy businesses and consumers'*.[5]

TransGrid is currently preparing its regulatory proposal for its next regulatory determination period, and the current uncertainty and delay in resolving the NSW/ACT appeals processes, and the subsequent reviews, have not constituted a material barrier to the development of that proposal. Further, the AER has itself lodged a Rule change with the AEMC to defer the Rate of Return guideline review by two years.[6] The outcome of the current LMR review will not therefore have any impact on the timing and uncertainty surrounding the subsequent Guideline revision process.

Fundamental to the need for an extension to the timetable that has been set down is that the first reviews under the post-2013 LMR regime are still to run their full course. In particular, TransGrid is deeply concerned that a full appreciation of issues cannot be gained until the AER has remade its 2015 determinations for the NSW and ACT electricity distribution businesses (or the current judicial review process has concluded that the determinations do not need to be remade) – not least since these determinations represent the 'road-block' that

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5 COAG Energy Council's consultation paper, p. 5.

6 The AER Rule change proposal can be accessed at: http://www.aemc.gov.au/Rule-Changes/Rate-of-Return-Guidelines-review#

has led to repeat applications for review of substantially the same issues in subsequent AER determinations.

TransGrid considers that option 4 in the consultation paper (removal of access to LMR) can neither be justified in terms of the performance of the arrangements to date, nor is it tenable in terms of ensuring that the regulatory framework provides adequate accountability for regulatory decisions, and sufficient certainty for investors.

If substantial, further LMR reform options are to be contemplated (as is contemplated under option 2), the focus should be on changes to the current arrangements rather than the removal of a LMR function. The changes being proposed in the Energy Networks Association's submission are worthy of consideration in this regard. Reform avenues may also usefully consider the process by which re-determinations are made, following an LMR decision.

Finally, in considering reform options, the policy formation process needs to accommodate a proper, independent assessment of the costs and benefit of any such options, before final decisions are taken. A draft report containing detailed recommendations and reasoning should then be published and consulted on, consistent with standard practice. The final report provided to Ministers should also be published.

1. Introduction

TransGrid welcomes the opportunity to make this submission to the Senior Committee of Officials (SCO), and thereby contribute to the review of the limited merits review (LMR) regime (the review), as recently instigated by the COAG Energy Council.

TransGrid is in the unique position of its ownership having recently transferred from the NSW Government to a consortium of both Australian and international investors. That process involved an injection of $10.3 billion of private debt and equity capital into the electricity network and telecommunications sectors, thereby freeing up an equivalent sum for investment by the NSW Government in new, public infrastructure projects.

The providers of that capital are deeply concerned at the hasty nature of the process that has been established by the COAG Energy Council for this review, and some of the perspectives put forward in the consultation paper.

Rather than increase policy and regulatory certainty, the timetable for the review itself as well as many of the premises on which the SCO consultation paper proceeds, have had precisely the opposite effect. The LMR regime is a fundamental pillar of the regulatory framework applying in the energy sector, and hasty or ill-considered reforms have the potential to inflict lasting damage to the perception of Australia as an investment environment with low sovereign risk.

We explain the basis for these concerns in this submission, which is structured into further sections, as follows:

- Section 2 discusses TransGrid's unique position and its perspective on the important value of the LMR function;
- Section 3 explains why TransGrid considers that the problems that have been identified in the consultation paper in relation to the operation of the LMR regime are currently misdirected;
- Section 4 sets out TransGrid's fundamental concern that the current review process is inadequate for the changes being contemplated, and should be substantially revised;
- Section 5 discusses the role that LMR plays in a well-functioning regulatory framework, and highlights the pervasiveness of LMR arrangements throughout other sectors in Australia, as well as overseas;
- Section 6 builds on this by providing examples of where the LMR process has enabled the correction of material errors in previous AER determinations, highlighting the role of LMR in driving improvements in future regulatory decisions;
- Section 7 explains that LMR is working and the LMR applications post-2013 reflect the fundamental changes to the regulatory arrangements introduced in 2012, and need to be considered in that light. It also demonstrates that:
  - the number of LMR applications post-2013 reflects the overlapping timing of the AER's regulatory determinations, and the subsequent appeals processes;
  - there is a high degree of commonality of issues across the LMR applications, which strongly suggests that once the 'roadblock' of the NSW/ACT determinations has been resolved, resolution of the remaining LMR applications should follow reasonably swiftly; and
- Section 8 discusses the process that TransGrid suggests should be adopted by SCO in identifying and consulting on options for any amendment of the LMR regime, and

highlights that reform avenues may also usefully consider the process by which re-determinations are made following the LMR process.

TransGrid urges the SCO to recommend to Ministers that the review process should be extended beyond its presently contemplated early December decision point so as to accommodate a more carefully considered approach to both the nature and extent of any problems with the LMR regime that need to be addressed, and the appropriate policy responses.

Fundamental to the need for an extension to the timetable that has been set down is that the first reviews under the post-2013 LMR regime are still to run their full course. In particular, TransGrid is deeply sceptical that a full appreciation of issues can be gained until the AER has remade its 2015 determinations for the NSW and ACT electricity distribution businesses (or the current judicial review process has concluded that the determinations do not need to be remade) – not least since these determinations represent the 'road-block' that has led to repeat applications for review of substantially the same issues in subsequent AER determinations.

Finally, if substantial, further LMR reform options are to be contemplated, the focus should be on changes to the current arrangements rather than the removal of LMR. In considering reform options, the policy formation process needs to accommodate a proper, independent assessment of the costs and benefit of any such options, before final decisions are taken.

2. TransGrid

2.1 TransGrid's operations and ownership arrangements

TransGrid is the operator and manager of the high voltage transmission network connecting electricity generators, distributors and major end users in New South Wales and the Australian Capital Territory. TransGrid's network is also interconnected to Queensland and Victoria, and is instrumental to an electricity system that allows for interstate energy trading.

TransGrid is in the unique position of, on 16 December 2015, its ownership having recently transferred from the NSW Government to a consortium of both Australian and international investors. That process involved the injection of $10.3 billion of private debt and equity capital into the electricity network sector, thereby freeing up an equivalent sum for investment by the NSW Government in new, public infrastructure projects.

TransGrid's financiers represent a wide spectrum of capital market interests, in terms of the diversity of both domestic and internationally domiciled institutions. TransGrid currently has circa $4.9 billion of facilities from a syndicate of banks, including the likes of ANZ Banking Corporation, Commonwealth Bank of Australia and Westpac Banking Corporation. In July 2016, TransGrid completed a A$1 billion private placement to a range of United States institutions for maturities of up to 17 years.

Investors in TransGrid have committed substantial capital to the electricity network sector, both to acquire the business and to seek opportunities for efficiency enhancement and growth (both within and outside TransGrid's regulated activities), including through the commitment of substantial further capital.

A significant factor in that capital commitment was the existence of a stable, well-functioning regulatory regime, including the option to seek merits review of revenue determinations by the

AER – a matter that was emphasised to potential investors in the due diligence material provided by the NSW Government

2.2 TransGrid strongly values the LMR function by not overusing it

Notwithstanding the option to seek review of its 2015 revenue reset determination by the AER, TransGrid elected not to seek such review, even though the AER's determination was made on the same timetable and by reference to the same framework as the AER determinations for the NSW/ACT electricity distribution network service providers, each of which did seek merits review.

A substantial consideration in TransGrid's decision not to seek LMR was that, although it did not agree with several significant aspects of the AER's decision (e.g., cost of equity, gamma), TransGrid was not sufficiently confident that the aggregate of the errors it considered had been made by the AER would give rise to a different, materially preferable decision.

A significant particular consideration in this assessment was that – in contrast to the NSW/ACT electricity distribution businesses – the AER did not seek to apply a zero-based, benchmark review of TransGrid's opex allowance in its 2015 revenue reset determination.

The distinct circumstances applying to TransGrid, and the different decision it made in relation to the AER's 2015 determination, serve to emphasise that the LMR framework is operating as intended. In particular, the principal functions of the LMR regime are:

- to clarify how fundamental elements of the rules are to be interpreted and applied;
- to strengthen the accountability of both the AER and service providers/consumers in operating within that framework of the rules; and
- ultimately, for the aggregate of any corrections to be weighed against the threshold as to whether or not there is a materially preferable decision that is in the long term interests of consumers.

TransGrid's fundamental proposition to the review is that the LMR function – as amended in 2013 – is operating as intended to secure these goals, and there is little or no need for material change.

3. This review has a misdirected problem definition

TransGrid is deeply concerned by the content of the consultation paper, and particularly by its observation[7] that, in the twelve reviews of the AER's decisions initiated under the post-2013 LMR regime:

> *network businesses [have] asked the Tribunal to increase their revenue by around $7 billion over a five year period.*

TransGrid submits that the portrayal of the matters at stake in the current review as amounting to increased revenues of network businesses is a misleading and unhelpful perspective on the issues to be addressed.

[7] COAG Energy Council's consultation paper, p. 4.

Rather, the principal function of the LMR regime is to ensure the appropriate application of the established framework of laws and rules, so that:

- on one hand, consumers pay prices that are not greater than necessary to reveal – including through various incentive mechanisms – and reflect the efficient cost of providing energy network services; and
- on the other hand, the need for service providers to be compensated for the cost of providing those services, including a reasonable return on their invested capital.

The law and rules established under the national electricity and gas laws have been explicitly designed to evaluate these competing considerations, against the touchstone of efficient investment in and use of the electricity system, for the long term interests of consumers (the 'National Electricity Objective' or NEO).

The AER's role is to impartially apply the rules and laws that, together, make up this framework in a manner that discharges its obligations effectively and efficiently, in the long term interest of consumers. A critical ingredient in ensuring that outcome is the role of merits review arrangements, not only in clarifying the appropriate application of the law and rules but also in delivering long term accountability and predictability of regulatory decision-making. The stability and accountability so delivered is, itself, in the long term interests of consumers.

The fact that – in the context of the first set of applications of significantly revised rules – the parties have identified matters of difference that involve sums as significant as $7 billion underlines the importance of the LMR framework for resolving the ambiguities and or inadequate accountability implied by this sum.

In the current context, a careful review of the circumstances and matters leading to the applications for merits review of AER determinations (by both network businesses and consumer groups) reveals that the 'problem' to be addressed can be characterised as:

- the substantial rule changes made in 2012 introduced significant discretion for the AER in relation to two critical elements of energy network price/revenue determinations, ie, the allowed rate of return, and the allowance for operating expenditure;
- it should be unsurprising that, in the first application of these new rules, parties would use the LMR function to clarify the principles by which they should be interpreted and applied, so that the initial applications for review represent an inevitable and desirable part of a 'bedding down' process;
- put another way, the development of a body of precedent that was an explicit objective of the post-2013 LMR regime[8] cannot be achieved without the parties first being prepared to invest in seeing through the review of those new elements of the rules;
- the significant, new elements of the LMR function put in place in 2013 – being the need to consider whether there is a materially preferable decision and a presumption of remittal to the AER – are still to be given effect, with the delay in doing so arising only through a decision by the AER not to proceed with implementing the February 2016 decision of the Australian Competition Tribunal (the Tribunal); and
- the bulk of the delay and the 'piling-up' of LMR applications arises from the decision by the AER to refer fundamental matters of interpretation for legal review by the Full Federal

[8] SCER *Regulation Impact Statement, Limits Merits Review of Decision-making in the Electricity and Gas Regulatory Frameworks, Decision Paper*, 6 June 2013, p. 33-34.

Court – a decision with limited precedent in the operation of either this or any other LMR regime applying in Australia.[9]

The existence of twelve applications for review of decisions by the AER does not establish any form of presumption that the outcome of the LMR process can be portrayed as denying lower prices to consumers, any more than it can also be portrayed as a denying reasonable returns to investors.

4. Current review process inadequate for the changes being contemplated

The Terms of Reference (TOR) for the current review requires that it be:

- open, transparent and consultative
- consistent with best practice regulation.

However, the review process is unlikely to meet these requirements.

TransGrid fully accepts that a review of the LMR regime has been scheduled to take place for some time, under a process that was to be initiated in the latter part of this year. However, the process that was provided for at the time the 2013 LMR reforms called for a review to be *initiated* by 1 December 2016, rather than concluded on an expedited basis by that date.

TransGrid's understanding is that, in order to be included for decision at the COAG Energy Council December meeting, the findings of the review must effectively be concluded by mid-October – this means that the review process:

- effectively extends to only two months – having first been announced on 19 August 2016;
- crucially, provides for only two weeks to consider submissions and finalise the recommendations; and
- offers no opportunity to respond to draft findings.

The expedited nature of the process is an anathema to good public policy decision making – particularly, for an issue of such fundamental importance – with substantial potential repercussions for the availability of capital and the prices that consumers pay.

4.1 Review process not consistent with regulatory best practice

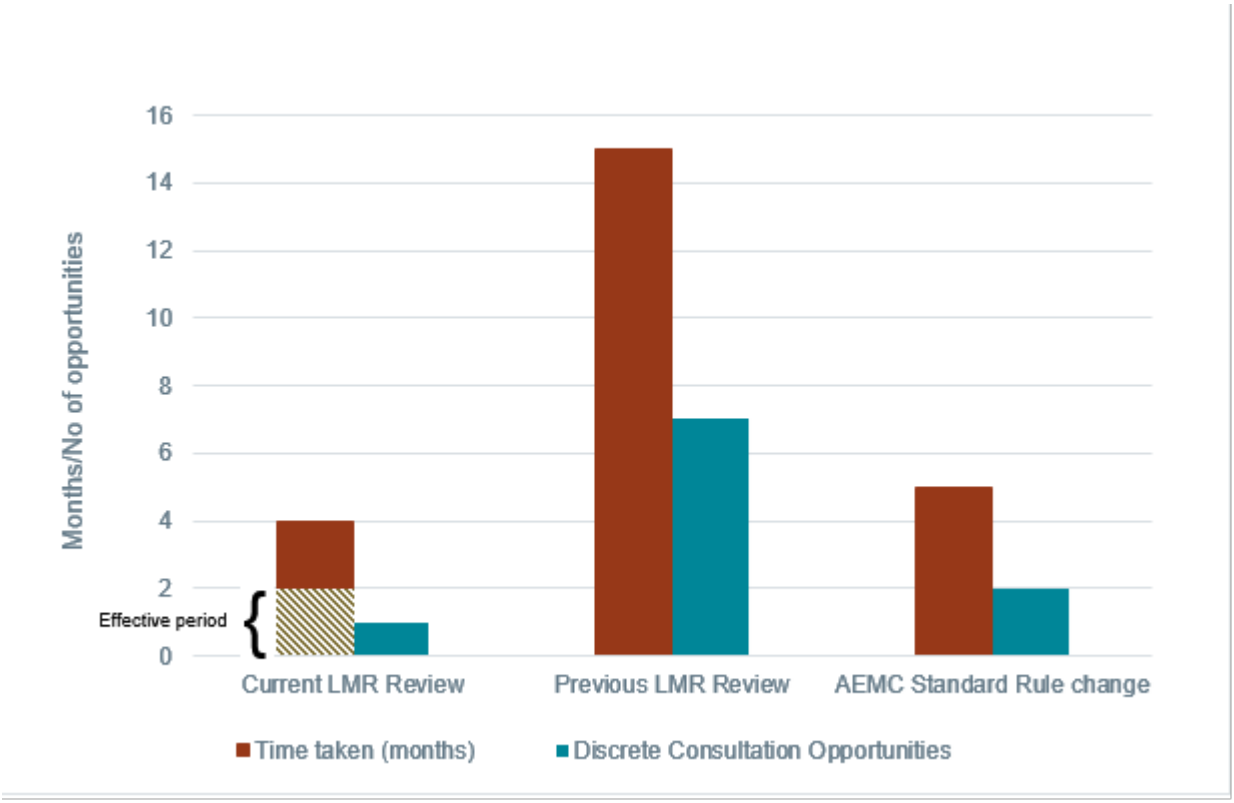
The process falls well short of the TOR requirement to be 'consistent with best practice regulation'. It is therefore at odds with the standard of a regime that evolves over time on the basis of well-understood processes that allow opportunities for stakeholder consultation. As a consequence, the timetable of the review has itself increased the degree of uncertainty in the sector, with potentially damaging effects on the perception of Australia as an investment environment with low sovereign risk.

Figure 1 below contrasts the current LMR review process with that adopted in the previous 2012-13 review of the LMR regime, as well as with other standard regulatory processes in the

[9] The ACCC did previously seek judicial review of a 2004 Tribunal decision relating to the access arrangement for the Moomba to Sydney Pipeline. (Australian Competition & Consumer Commission v Australian Competition Tribunal [2006] FCAFC 83 (2 June 2006)). To TransGrid's knowledge, none of the network businesses have previously sought judicial review of a Tribunal decision.

energy sector – highlighting both the substantially shorter period allowed for the review, as well as the fewer opportunities provided for consultation with stakeholders.

Figure 1: Current LMR review process not consistent with regulatory best practice



The review of the LMR arrangements in 2012-13 took 15 months in total - from the commencement of the Expert Panel in March 2012 until the publication of the Final Decision Regulatory Impact Statement by the, then, Standing Council on Energy and Resources (SCER)[10] in June 2013. It also proceeded in several stages, with four consultation papers plus opportunities to respond to the draft recommendations at each of the three main reporting stages (including on the final recommendations provided to SCER). The details of the previous consultation process are set out in Appendix A.2.

In contrast, as noted above, the current review is scheduled for completion within four months (with potentially an even shorter effective timetable), with only one substantive opportunity for stakeholders to provide input.

More generally, adequate consultation requires a significantly more extended timeframe, which incorporates opportunities for stakeholders to review and respond to draft recommendations, as well to provide their input ahead of the development of those recommendations.

Most regulatory and policy agencies adopt this approach. To take the standard AEMC Rule change process as an example, the typical time taken for a standard Rule change is just over

[10] Now the COAG Energy Council.

five months,[11] and provides opportunities for consultation and submissions at both the commencement of the process and on the draft Rule and draft Determination. Further, this is the process for relatively straightforward rule changes, with more complex rule changes, and AEMC reviews, taking substantially longer and often involving further opportunities for stakeholders to provide input.

Similarly, the Productivity Commission incorporates opportunities for consultation both prior to and following publication of its Draft Reports (usually at the formal direction of the Commonwealth Treasurer) as a matter of course. Reviews by the Productivity Commission of infrastructure policy typically take nine to fifteen months. Opportunities for consultation on draft recommendations have also been a core feature of other recent review processes in the sector, such as the Harper Review.

4.2 No case for an expedited process

Aside from the usual standards of sound policy formation, in this particular instance TransGrid does not consider that there is a case for an expedited process to be applied.

TransGrid does not accept the explicit premise underpinning the review (which has apparently driven the severely truncated consultation timetable) that decisions on potential reforms to the LMR framework are needed before the end of this year in order:

> *to increase policy and legislative certainty for the AER, regulated energy businesses and consumers [consultation paper, page 5].*

TransGrid is currently preparing its regulatory proposal for its next regulatory determination period (2018-2023), and the current uncertainty and delay in resolving the NSW/ACT appeals processes, and the subsequent reviews, have not constituted a material barrier to the development of that proposal.

In addition, the AER has itself lodged a Rule change with the AEMC to defer the Rate of Return guideline review by two years, on the basis that key elements of the current Guideline are still in contention before the Australian Competition Tribunal and Federal Court of Australia.[12] The outcome of the current LMR review will not therefore have any impact on the timing and uncertainty surrounding the subsequent Guideline revision process.

Further, given the particular status of the reviews that are presently in train, TransGrid considers that it is currently too early to draw meaningful conclusions as to the fundamental success or otherwise of the 2013 reforms. Relevantly, the judicial review hearings for the ACT/NSW determinations are scheduled to begin in mid-October. The findings of that review can be expected to have material implications for both the on-going resolution of the ACT/NSW determinations (as well as the matters currently in dispute in South Australia, Victoria and Western Australia), as well as any assessment of the performance of the LMR regime as a whole.

On these considerations, TransGrid urges the SCO to recommend to Ministers that the review process should be extended beyond its presently contemplated early December decision point so as to accommodate a more carefully considered approach to both the nature and extent of

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[11] AEMC Annual Report 2014/15, p. 27. Average period for completion of a standard Rule change in 2014/15 was 156 days.

[12] The AER Rule change proposal can be accessed at: http://www.aemc.gov.au/Rule-Changes/Rate-of-Return-Guidelines-review#

any problems with the LMR regime that need to be addressed, and the appropriate policy responses.

In particular, the review should be scheduled for completion only once the still current, first round of reviews had been concluded – including the re-determination of the 2015 AER determinations for the NSW and ACT electricity distribution businesses, which currently represent the 'road-block' that has led to repeat applications for LMR of substantially the same issues in subsequent AER determinations (as discussed further in section 7.3).

Further, if substantial, further LMR reform options are to be contemplated, TransGrid considers that regulatory best practice requires the process to accommodate a proper, independent assessment of the costs and benefit of any such options, before decisions are taken, and for draft recommendations for change to be subject to adequate stakeholder consultation. Following this assessment, a draft report to Ministers should be published and consulted on, and the final report to Ministers should also be published, consistent with the practices of other policy review processes affecting substantial infrastructure sectors.

5. Importance of LMR for investors and consumers

Capital is sourced from global markets, with the stability of policy and regulatory settings forming an important context that global investors take into account in assessing the risks associated with their investments.

The providers of debt and equity finance for infrastructure investment are attracted to (and so more willing to make capital available for) investment in regulatory regimes that:

- are stable, and function independently from day-to-day government and political interference;
- separate the rule making function from the regulatory task of applying those rules;
- encourage clarity, consistency and accountability of regulators through the existence of an effective review regime; and
- evolve over time on the basis of well-understood processes that allow opportunities for stakeholder consultation.

It is vital that policy makers remain cognisant of the fundamental importance of the current LMR regime to investors, and the adverse implications for business' credit ratings and the current high standing of the Australian regulatory environment in the eyes of overseas investors that would accompany any substantive watering down of the current LMR framework.

Similarly, consumers and their representative groups have clearly shown that the opportunity to play a more active role in the regulatory process, including through participation in any merits review process – and, as befits the circumstances, through the opportunity to initiate a merits review – adds significantly to the legitimacy of the regulatory process and outcomes.

5.1 LMR is an important part of well-functioning regulatory frameworks

The recognition of the importance of a review mechanism in any well-functioning regulatory regime is a long standing and uncontroversial principle.

The ACCC, in its 2015 international review of regulation of infrastructure, notes with regard to the process of appeals in general, that:[13]

> *"a process of appeal from the decisions of these agencies is generally regarded as important to ensure that the regulator exercises its powers lawfully and appropriately" (page 72)*

Smith (1997), in a paper for the World Bank, provides an overview of key institutional design considerations when establishing regulators, and comments that:[14]

> *"The appeals process is important to ensure that the regulator does not stray from its mandate and that it remains accountable"*

The ACCC notes that some form of substantive review of regulatory decisions is conducted in the majority of comparator countries, albeit with different limitations on review and in different forms depending on the context.[15] For example:

- In New Zealand, periodic determination of the 'input methodologies' for price decisions can be subjected to a merits review;
- In Ireland, merits review appeals are limited to certain regulatory matters;
- In most EU states 'it is a requirement under the telecommunications directives that decisions of national regulatory agencies are subject to substantive review' (page 84). For example, in Germany, specialist regional and general administrative courts can conduct substantive 'merits' review of BNetzA decisions; and
- In the Netherlands substantive review is available of most decisions by the Authority for Consumers & Markets, after internal review processes have been exhausted.

The ACCC review also highlights that, in those circumstances where standalone merits reviews are not typically conducted, there is usually an internal, independent review process. For example:

- in Canada in the energy sector;
- in the US with the FERC and FCC;
- in the Netherlands, a full substantive review can be conducted by a separate team within that regulator; and
- in New Zealand in telecommunications.

In Australia there is an LMR regime operating at a state level for the jurisdictional regulators in Victoria, South Australia, the ACT, Tasmania and the Northern Territory (see appendix A.3). In addition, the Competition and Consumer Act 2010 includes merits review provisions for decisions made by the ACCC and Ministers (discussed further below).

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[13] ACCC (2015), International Insights for the Better Economic Regulation of Infrastructure, Working Paper No. 10, Australian Competition and Consumer Commission, March 2015

[14] Smith W (1997), 'Utility Regulators – Decision making Structures, Resources, and Start-up Strategy', Public Policy for the Private Sector, 129, World Bank, Washington, October, pp. 1-4.

[15] R. Albon and C. Decker (2015), International Insights for the Better Economic Regulation of Infrastructure, Working Paper No. 10, ACCC, March 2015

5.2 The regulator has substantial discretion

The Stage Two Report from the Expert Panel in the 2012-13 LMR review concluded that, despite the weaknesses associated with the then current form, a merits review process is overall a key part of the regulatory framework:[16]

> *"We are convinced of the contribution that merits review can make to better regulatory decision making, and, more specifically, we consider it to be an important component of a system of checks and balances that supports the independence of delegated regulation." (page 3)*

Further, the Expert Panel noted that the role of the merits review is largely due to the discretion afforded to the AER in making its regulatory decisions:

> *"It is because the Australian Energy Regulator (AER) can exercise significant discretionary powers that merits review has such an important potential role to play." (page 3)*

Dr Michael Vertigan, chair of the Gas Reform Group recently appointed by the COAG Energy Council, has also articulated the need for merits review in circumstances where a regulator has substantial discretion (in the context of the independent review of broadband):[17]

> *Providing for merits review is all the more important as those concerns [of stakeholders], or others of substance, will doubtless recur in the years ahead. It is not satisfactory for matters of such importance, and with so great a bearing on end-users, taxpayers and investors, to be determined by a regulatory body, operating under legislation that itself provides only very general guidance, with virtually no possibility of substantive review.*
>
> *Given that, the panel is concerned that the wide-ranging discretions that the regime vests in the ACCC mean that the risks and costs of regulatory error are potentially very high, with virtually no checks and balances in place to curb any resulting harms. As a matter of principle it is inappropriate, and offensive to the norms of good government, that regulators should be left to regulate themselves….*
>
> *It is therefore appropriate that decisions of enduring impact be subject to regulatory oversight and decisions in relation to access determinations should be subject to merits review."[18] [emphasis added]*

5.3 Calls for abolition of LMR amounts to an expression of bad faith

The fact this particular review has explicitly raised the option of abolishing access to the current LMR regime amounts to an expression of bad faith to consumers, who have exercised this right to initiate and be heard under the current regime, and to the investors and banks that

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[16] Yarrow, G., Egan, M. & Tamblyn, J. (2012), Review of The Limited Merits Review Regime - Stage Two Report, 30th September 2012

[17] *Independent cost-benefit analysis of broadband and review of regulation*, Statutory review under section 152EOA of the Competition and Consumer Act 2010, June 2014, pp. 118-119.

[18] *Independent cost-benefit analysis of broadband and review of regulation*, Statutory review under section 152EOA of the Competition and Consumer Act 2010, June 2014, p. 59.

have contributed billions of financial capital to this industry on the understanding that the regulatory regime is stable and not prone to sudden changes of course.

TransGrid noted the apparent inconsistency between the views of the state of Victoria, which has publicly expressed its disquiet with the existence of the current energy LMR regime, [19] yet:

- itself established the first merits review function applying to energy sector price determinations at the time it privatised its gas and electricity network service providers in the late 1990s; and
- retains a merits review function for regulatory decisions made by the Essential Services Commission of Victoria and, no doubt, has reaped the benefits of the continued existence of its state-based regime in its recent sale of a 50-year lease for the Port of Melbourne.

Further, any move to abolish LMR in the NEL would seem to be inconsistent with other policy actions taken by a number of other Australian governments:

- the state of South Australia also found it beneficial to establish a merits review function applying to energy sector price determinations at the time it privatised its electricity network service provider in the late 1990s;
- Western Australia has made use of a merits review function that it put in place for the review of energy sector regulatory decisions, also at the time it privatised several marquee energy assets (the Dampier to Bunbury Natural Gas Pipeline (DBNGP) and the Perth gas distribution network);
- at the federal level, once privatised, the Australian government was willing to remove the merits review function that operated in relation to Telstra – a decision opposed by the Productivity Commission[20] and by the Vertigan review of the regulatory arrangements to apply to both Telstra and NBNCo.[21]
  - However, the Australian Government has explicitly said it would be willing to consider the reintroduction of a merits review function for NBNCo, in the event it was to contemplate privatisation of that entity;[22] and
- the *Competition and Consumer Act 2010* (Cth) provides for merits review of a range of decisions. Most relevant are the range of provisions contained within Part IIIA, the national access regime, which not only provide for review of arbitration decisions by the ACCC but also coverage decisions made by relevant Ministers.

TransGrid considers that option 4 in the consultation paper (removal of access to LMR) is not tenable, given its fundamental importance to the overall regulatory framework in terms of ensuring adequate accountability for regulatory decisions, and sufficient certainty for investors.

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[19] The Premier of Victoria has stated that "the Andrews Labor Government welcomes COAG Energy Council's decision to evaluate the limited merits review regime…Currently electricity distribution businesses can appeal decisions made by the Australian Energy Regulator (AER) regarding what electricity businesses may charge for network access…This system allows large power companies to 'cherry pick' parts of the decision they oppose and appeal, while pocketing the parts they do like… As Minister for Energy, Environment and Climate Change I have been concerned about the significant costs involved which are ultimately borne by consumers. That is why earlier this month I called on COAG to urgently review this process." – see: Premier of Victoria website, available at: http://www.premier.vic.gov.au/statement-on-coag-energy-council/

[20] Productivity Commission, Telecommunications Competition Regulation, Inquiry Report, 21 December 2001, p. 193.

[21] *Independent cost-benefit analysis of broadband and review of regulation*, Statutory review under section 152EOA of the Competition and Consumer Act 2010, June 2014, pp. 118-119.

[22] Commonwealth Government of Australia, *Telecommunications Regulatory and Structural Reform*, December 2014, p. 7.

6. LMR has operated to clarify the regulatory framework and improve initial regulatory decisions

The practical experience of the LMR regime in the Australian energy sector to date shows that it has played a fundamental and necessary role in the evolution and clarification of the regulatory framework.

When set alongside any other regulatory body in Australia of which we are aware, the AER has a poor-track record in terms of having its decisions overturned on review by the Competition Tribunal. This is consistent with the concerns in relation to AER performance identified by the 2015 COAG Energy Council commissioned review of governance arrangements:23

> The Panel is mindful of a certain level of stakeholder disquiet with the outcomes of past price reviews and, while recognising that some friction is fairly normal in such matters, it takes the view that there is scope for improvement.

The performance of the AER, and the opportunity to strengthen that performance by establishing the AER as an independent organisation, were matters identified in the 2015 COAG Energy Council commissioned review of energy market governance arrangements. 24

It is instructive to note that the ERA operates under the same LMR framework as the AER, but does not have the same track-record of substantial aspects of its decisions being overturned on appeal. Following the 2013 changes to the LMR regime, the Tribunal's decision in July this year on an application brought by ATCO Gas for LMR upheld all of the areas of the ERA's determination on which review was sought, with the exception of the ERA's approach to gamma.

6.1 The Tribunal has previously intervened to correct material errors in AER decisions

Rather than indicating a failure of the limited merits review regime applying in the energy sector, the record shows that the Tribunal has often intervened to correct material errors in the AER's decisions.

That such errors may occur should perhaps not be unexpected, given the breadth and complexity of the issues that need to be considered by the AER in making price and/or revenue determinations. Further, in some instances the existence of error has been uncontroversial – in several cases, the AER has conceded these errors before the Tribunal.[25]

Moreover, in identifying material errors, the Tribunal has often not been required to adjudicate debates of a highly technical or complex nature on which different practitioners may reasonably disagree.

Rather, after considering the process by which the AER has arrived at some of its decisions and the evidence put before it, the Tribunal has often drawn a 'common-sense' conclusion that

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[23] Dr Michael Vertigan et al, *Review of Governance Arrangements for Australian Energy Markets, Final Report*, October 2015. p. 73.

[24] Dr Michael Vertigan et al, *Review of Governance Arrangements for Australian Energy Markets, Final Report*, October 2015. p. 8.

[25] See, for example Application by Energex Limited (No 2) [2010] ACompT 7 (13 October 2010).

errors have been made, with such observations including (emphasis added in the quotes below):

- The absence of any basis for the conclusions that the AER reached:

  The AER's submissions in support of its decision all fail because it did not have sufficient reason to believe that the proposed averaging periods were unlikely to produce an unbiased estimate of CGS rates in the regulatory control period[26]

- The giving of insufficient weight to material placed before it:

  We think this is too cursory a rejection of the relevance of differently rated bonds. It is one thing to hold that a differently rated bond should not be given equal weight. It is quite another to refuse to take it into account in any way.[27]

- The absence of internal consistency in the AER's reasoning:

  … this simple averaging adjustment has no logic to it …[28]

- A absence of robustness in the underlying data that the AER used to draw its conclusions:

  … at this point in its evolution the RIN data is not data upon which the AER might rely on to the extent that it did… to determine the benchmark opex that would be incurred by an efficient DNSP…[29]

These examples sit counter to the suggestion put forward in the consultation paper that:[30]

> *regulatory determinations and access arrangements for monopoly businesses in the energy sector may be too complex, technical and subjective for LMR.*

The particular findings cited above are also fully consistent with the intent of the revised LMR regime, as expressed in the SCO's December 2012 Statement of Policy Intent that:

> *The review process should promote an accountable and high performing regulator such that material error is minimised.*

6.2 LMR establishes and validates a body of precedent that over time will improve initial regulatory decision-making

Further, once an error has been identified, the post-2013 LMR regime establishes a presumption that technical issues will be referred back to the AER for re-determination[31] – in other words, there is no basis upon which the Tribunal's potentially more 'lay person's perspective' on a particular issue can be substituted for the regulator's more technical capabilities, once the underlying error has been identified.

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[26] Application by EnergyAustralia and Others (includes corrigendum dated 1 December 2009) [2009] ACompT 8 (12 November 2009), para 104.

[27] Application by ActewAGL Distribution [2010] ACompT 4 (17 September 2010), para 61.

[28] Application by Energex Limited (No 2) [2010] ACompT 7 (13 October 2010), para 95.

[29] Applications by Public Interest Advocacy Service Ltd and Ausgrid Distribution [2016] ACompT 1 (26 February 2016), p. 260.

[30] COAG Energy Council consultation paper, p. 13.

[31] SCER, *Regulation Impact Statement, Limited Merits Review of Decision Making in the Electricity and Gas Regulatory Frameworks, Decision Paper*, 6 June 2013, SCER's Policy Position (p. 2) and p. 41.

In addition, the LMR regime plays a key role in establishing a body of precedent, so that all parties know how the regulatory regime under the NEL is to be applied – particularly in the face of revisions to fundamental elements of the framework such as the 2012 changes to the National Electricity Rules (NER) and National Gas Rules (NGR) (collectively, the Rules).

For example:

- the Tribunal's 2016 decision on the NSW/ACT determinations, which were the first following the 2012 Rule changes, upheld the AER's use of the CAPM to determine the return on equity, as consistent with the revised Rules framework
- this now establishes a precedent for future AER (and ERA) determinations, and appears to make this area less likely to be the focus of both regulatory debate and future LMR challenges.[32]

Changes to the LMR regime whilst the initial determinations following the 2012 changes to the Rules are still subject to the review process would eliminate the prospect of establishing precedent value that the existing process can be expected to create.

This would prolong the uncertainty around the interpretation of the 2012 Rule changes, and therefore the approach that the AER may take to setting future prices or revenues.

The AER's decision to seek judicial review of areas of the Tribunal's decision in relation to its NSW/ACT determinations which did not uphold the AER's approach, and not to progress a re-determination in the interim, has also substantially extended the timeframe for the 'bedding down' of the approach under the 2012 Rule changes.

Relevantly:

- this a decision with limited precedent in the operation of either this or any other LMR regime applying in Australia[33]; and
- the network businesses did not seek judicial review of the Tribunal's decision to uphold the AER's approach to the cost of equity.

6.3 The AER has not always been willing to adopt precedent

Although the formation of precedent can be expected over time to 'narrow the field' of those issues that remain contentious, TransGrid notes that the AER has made the decision not to accept such precedent. This provides a further rationale for the SCO to exercise strong caution in considering the potential removal of LMR.

By way of example, several of the earlier LMR cases concerned the AER's continuing approach to determining 'gamma' – where the AER declined to accept the precedent established by the Tribunal, and repeatedly adopted an approach that had clearly been rejected as inconsistent with the Rules, and so these decisions became the subject of further, successful, LMR applications.

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[32] Two of the LMR applications on the cost of equity (SAPN, ATCO gas) pre-date the Tribunal's 2016 determination for the NSW/ACT electricity distribution businesses. The Tribunal's decision in the LMR application following the 2016 decision on this issue (DBGP) can be expected to consider to what extent different issues are relevant in the context of the decision having been made by the ERA, which has developed its own Rate of Return guideline.

[33] The ACCC did previously seek judicial review of a 2004 Tribunal decision relating to the access arrangement for the Moomba to Sydney Pipeline. (Australian Competition & Consumer Commission v Australian Competition Tribunal [2006] FCAFC 83 (2 June 2006)). To TransGrid's knowledge, none of the network businesses have previously sought judicial review of a Tribunal decision.

Currently, the AER is also continuing to make decisions on new determinations, consistent with approaches that have been rejected by the Tribunal in its 2016 decision.

The AER's chosen actions to not appear consistent with the SCER's 2012 Statement of Policy Intent, which refers to:

> *Maximising the conditions for the decision-maker to make a correct initial decision, by providing an accountability framework that drives continual improvement in initial decision making* (emphasis added)

However, this is not a shortcoming of the LMR framework itself, but rather reflects a shortcoming of the AER's operation within this framework.

7. The current LMR process is working

There were substantive changes made to the Rules in 2012, applying to the making of regulatory determinations. Amongst other things, these changes increased the extent of the AER's discretion in relation to determining the two largest contributors to regulated revenue allowances – the cost of capital and operating expenditure (opex).

It is unsurprising that LMR has been sought for the first determinations the AER has made under these changed Rules. In particular, the NSW/ACT electricity determinations and the Jemena NSW gas determination were the first instances of the new Rules being applied by the AER, and the AER exercising that discretion.

In the case of opex in particular, the AER's approach under the revised Rules differed substantively from the approach it had previously applied, with material consequences for regulated revenues (for example, cuts to opex allowances of more than one third).

The application for LMR of the initial AER determinations under the new Rules are an inevitable part of the 'bedding down' of the 2012 Rule changes, and can be expected to clarify the limits to both the NSPs' and the AER's discretion under the amended Rules, leading to improvement in future regulatory decision making.

In consequence, the out-workings of the LMR process will establish important precedents in the interpretation of the amended Rules – which in turn can be expected to reduce future areas of debate and applications for review (as noted above).

The Tribunal's 2016 decision in relation to the NSW/ACT determinations upheld the AER's approach in some areas (in particular the use of the CAPM to determine the return on equity).

It also provided guidance that the weight the AER has placed on the outcomes from its opex benchmarking model were too great, given deficiencies in the data and that this was the first application of benchmarking in this form. The Tribunal's decision (in the absence of the AER's application for judicial review) can be expected to lead to re-consideration by the AER of its approach to determining opex and, hence, greater clarity of the regulatory approach permitted within the amended 2012 Rules.

7.1 The current LMR process has not currently concluded

A key part of the changes made to the LMR regime in 2013 was to put in place a presumption that Tribunal decisions would be remitted back to the AER to re-determine, with express consideration of whether or not a 'materially preferable' decision exists.[34]

The Tribunal's decision in relation to the NSW/ACT determinations was consistent with this, and remitted the decision back to the AER to re-make.

The Tribunal expressly noted that there are interlinkages that the AER should consider in its re-determination – in particular, that between gamma and the associated return on equity, which could see the overall resulting revenue outcome for the network businesses being substantially less than that associated with the change in gamma considered in isolation.

Moreover, the AER is expressly required – both by the NEL and by the Tribunal's direction to it in the case of the NSW/ACT re-determination – to consider whether its remade determination is 'materially preferable'.

It follows that it is too early to claim, as the consultation paper appears to seek to do, that the revisions in the LMR process have continued to lead to 'cherry-picking' and a 'focus on correcting individual errors without sufficient consideration of whether a different decision would lead to a materially preferable decision'.[35]

The ultimate outcome of the first LMR process is simply not yet known, and both the revised LMR framework and the comments made by the Tribunal within that framework give sound reason to expect that the eventual re-making of the AER's determination for NSW/ACT will take into account the inter-linkages in its determination, and need not provide 'only upside' for the regulated businesses.

As a consequence, it is too early overall to 'assess' the operation of the revised LMR regime. As noted earlier, such a review would appropriately wait for conclusion of both the federal court judicial review process and the (expected) subsequent re-determination by the AER of the initial NSW/ACT determinations.

7.2 The network component of consumer prices is falling

Analysis of data published by the AEMC shows that the network component of electricity prices paid by consumers in NSW has fallen steadily over the past three years.

Figure 2 below reflects TransGrid's analysis based on data sourced from the AEMC, and highlights the extent of the fall in NSW, together with the projected future decline.

These trends reflect the 2012 changes to the regulatory arrangements – which, as discussed above, sought to tighten the criteria applied to new capital and operating expenditure – as well as falling capital costs, as equity and debt returns reach historical lows.

The analysis shows that there is no factual basis for the apparent concerns expressed in the consultation paper as to the influence of network regulation on consumer electricity bills. Whilst consumers should not be asked to pay more than is necessary for network charges, a hasty review of the LMR function is not the right place to be searching for measures to be

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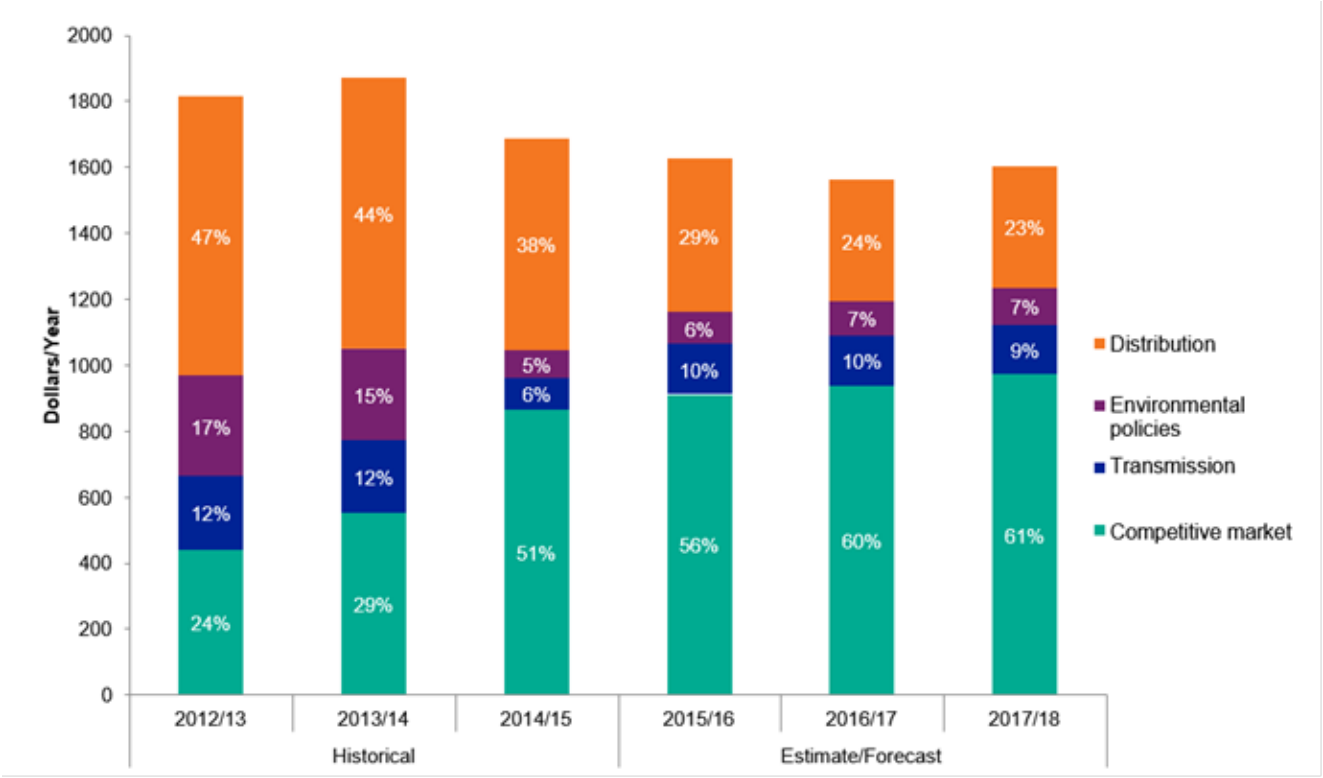
[34] Standing Council on Energy and Resources, *Regulation impact statement – Limited merits review of decision making in the electricity and gas regulatory frameworks (Decision paper)*, 6 June 2013

[35] COAG Energy Council's consultation paper, p 4

ameliorating the effect of rising electricity costs on business and household budgets. Rather, policy makers and regulators should be considering further the implications for prices arising from the current structure of the market, where it appears that gentailers have been able to capture price reductions from regulated sections of the value chain.

Figure 2: Annual bill for representative NSW household



Source: Trans Grid analysis of data from AEMC Residential Electricity Price Trends Reports 2013-2015

7.3 The number of post-2013 reviews reflects decisions taken by the AER

The consultation paper gives significant weight to the number of applications for LMR since the 2013 changes to the LMR regime, noting that:

> *twelve of the AER's twenty decisions being subject to LMR applications by the network businesses [page 4].*

This characterisation of the 'problem' with the current LMR regime as being the number of reviews is misjudged.

Of the twelve applications for LMR since 2013:

- Four stem from the AER's concurrent determinations for the NSW/ACT electricity DNSPs – these were the first determinations by the AER following the substantive changes made to the Rules in 2012;
- Five reflect the subsequent AER determination for the Victorian electricity DNSPs;
- All of these applications, as well as the LMR applications for three further AER determinations (Jemena NSW, SAPN, ActewAGL (gas)), have a high degree of commonality of the issues on which review was sought. In particular they each take a

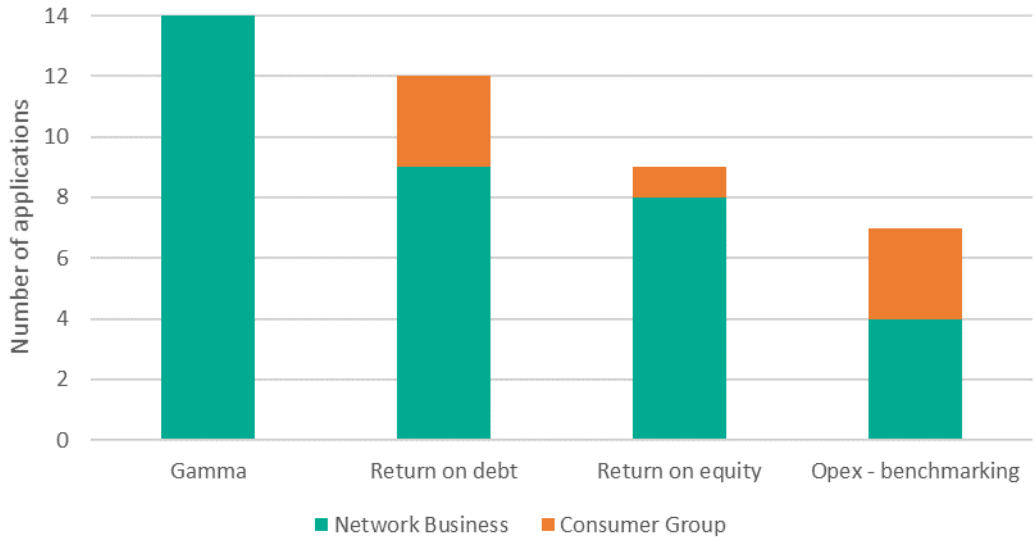
common path in relation to return on equity; gamma; the transition to a new return on debt methodology; and (for the electricity determinations) opex; and

- The applications for review were also initiated by consumer representatives for four[36] of the twelve determinations, in addition to the network businesses. The applications by consumer representatives also related to several of the same common issues: opex benchmarking, cost of debt and cost of equity.

Figure 3 below highlights the high degree of commonality in relation to the issues on which LMR of the AER's determinations has been sought, post 2013. Appendix A.3 provides a more detailed summary, across all of the AER and ERA determinations post-2013.

In short, there have been 18 applications made to the Tribunal for LMR since 2013, with 14 of these applications made by network businesses and the remaining four made by consumer groups. Of these 18 applications, 14 (78 per cent) sought review on gamma, 12 (67 per cent) sought review on the return on debt, 9 (50 per cent) sought review on the return on equity and 7 (39 per cent) sought review on opex benchmarking – as depicted below.

Figure 3: Number of LMR applications of AER decisions seeking review on gamma, return on debt, return on equity and opex benchmarking



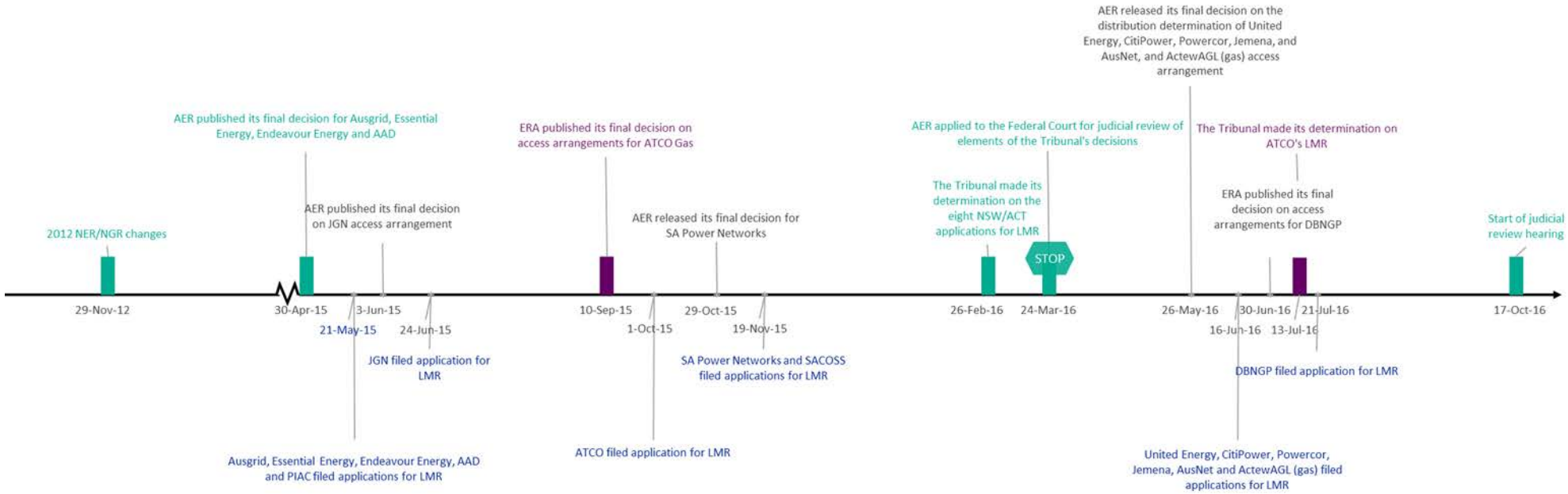
This commonality of the issues on which LMR has been sought arises from the overlapping timing of:

- the LMR process for the initial NSW/ACT determinations, and the AER's subsequent application of judicial review of the Tribunal's 2016 decision in relation to that review; and
- the AER's subsequent determinations.

The sequencing of the AER's determinations, the Tribunal process for the initial NSW/ACT applications and the subsequent applications for LMR is shown in the following timeline (together with the timing of the ERA's determinations and associated applications for LMR).

[36] SACOSS sought leave for LMR of the AER's decision for SAPN. The Tribunal decided not to grant leave as the matters raised by SACOSS had not previously been put in front of the AER.

Figure 4: The AER's application for judicial review has resulted in a 'backlog' of LMR applications



The timeline makes clear that the current 'backlog' of LMR applications in relation to AER determinations is a consequence of:

- the AER continuing with the same approach for certain aspects of its regulatory determinations for the Victorian and South Australian electricity distribution businesses, as well as in its determinations for the ACT and Victorian gas distribution businesses, despite its approach having been found by the Tribunal to be inconsistent with the Rules (and therefore the long term interests of consumers);
- the AER's decision to seek judicial review of those aspects of the Tribunal's 2016 decision that found against the AER;[37] and
- the AER's apparent unpreparedness to progress a re-determination of the 2015 NSW/ACT decisions in line with the Tribunal's findings, despite previous reassurances that it would:[38]

> *continue to consult with stakeholders about the remaking of its original decisions, as required under the Tribunal's findings, in order to maximise certainty and stability while the judicial review is underway.*

In the absence of resolution of the issues raised in the AER's initial NSW/ACT determinations, and in the face of the AER continuing to adopt the same approach in subsequent determinations (despite the findings of the Tribunal), the same issues have needed to be re-prosecuted by recourse to LMR in the AER's subsequent determinations.

Again, rather than demonstrating a failure of the current LMR framework, the current situation is directly explainable by reference to the determination timetable and the AER's decision to seek judicial review and not to progress a re-determination in the meantime. Once the dispute in relation to the current NSW/ACT process has been resolved, it can be expected that the findings would rapidly flow on in resolving the other applications for LMR, given the high degree of commonality involved.

8. Options for further investigation to strengthen the LMR framework

Given the points set out in the previous section, TransGrid considers that option 4 in the consultation paper (removal of access to LMR) can neither be justified in terms of the performance of the arrangements to date, nor is it tenable in terms of ensuring that the regulatory framework provides adequate accountability for regulatory decisions, and sufficient certainty for investors.

Moving to a system that allows only judicial review would be more narrow; very expensive; cumbersome in terms of providing for decisions to be remade; and prohibitive in terms of meaningful participation by consumer groups and other stakeholders.

[37] The AER has only sought judicial review of those areas of the Tribunal's decision where it found against the AER.

[38] AER appeals against electricity and gas price decisions, AER news release, 24 March 2016, available at: http://www.aer.gov.au/news-release/aer-appeals-against-electricity-and-gas-price-decisions (accessed 30 March 2016).

As discussed above, TransGrid is concerned that the consultation paper may have rushed to identify 'solutions' without adequate identification of what the current 'problems' are, and the circumstances that have given rise to the current situation. As a consequence, the current options 2 and 3 put forward in the consultation paper are not well-specified, and may not address the underlying issues which have given rise to the concerns noted by the SCO.

Before reform options can be identified, it is necessary to undertake a more thorough assessment of what the 'problems' to be addressed are, which may then lead to more appropriately specified options being put forward. The policy formation process then needs to accommodate a proper, independent assessment of the costs and benefit of any reform options, before final decisions are taken. As part of this process, a draft report containing detailed recommendations and reasoning should be published for further consultation, consistent with regulatory best practice.

Given that the present 'back log' of review applications can be attributed to choices made by the AER, options for strengthening the framework could usefully focus on ensuring the present circumstances are not allowed to develop again. This would include an assessment of the reasons why the AER has become an apparent 'roadblock' in the process.

From a resourcing perspective, the timing of the Tribunal's findings in relation to the review of the initial NSW/ACT decisions, and the potential for the Tribunal to require the AER to remake its earlier determinations, could have been foreseen – and so planned for by the AER – including the potential flow-on effects for its other, scheduled determinations.

Notwithstanding its application for judicial review, the AER could have taken the view that the integrity of the regulatory processes would have been strengthened if it was to proceed with a re-determination for NSW/ACT, and to adopt an approach in its subsequent determinations that was consistent with the Tribunal's findings.

Options for addressing these issues could include:

- a greater degree of prescription in the Rules as to the process and timing for determinations that need to be remade; and
- a renewed consideration of the governance and funding arrangements of the AER.

In relation to the last point, TransGrid notes that this is consistent with the recommendations of both the Harper Review and the 2015 Governance Review. This reinforces the importance of considering the operation of the LMR regime in the light of the performance of the wider regulatory framework and the institutions operating within that framework.

Finally, in considering options for change, it is vital that policy makers remain cognisant of the fundamental importance of the current LMR regime to investors, and the adverse implications for business' credit ratings and the current high standing of the Australian regulatory environment in the eyes of overseas investors that would accompany any substantive watering down of the current LMR framework.

A.1 Summary responses to questions raised in consultation paper

Question	Response
1. Are there any specific factors which prevent issues being resolved through the determination process?	Substantial changes to the Rules in 2012 which introduced wider discretion for the AER will inevitably require 'bedding down'. Once interpretation of the Rules is clearer, then initial regulatory decisions should be able to reflect this during the determination process, without need for recourse to LMR. See section 7.
2. Are reviews generally considered a routine part of the determination process?	No – but they form an important part of the arrangements in 'bedding-down' substantive changes to the regulatory arrangements, as occurred in 2012 (see section 7).
3. Does the framework enable reviews to focus primarily on the long term interests of consumers?	Yes – as evidenced by the presumption of remittal by the Tribunal back to the AER for re-determination. See section 7.1.
4. To what extent does the current LMR process support materially preferable decisions being made for the long term interests of consumers?	TransGrid considers that the current LMR process does support this, through the remittal of determinations back to the AER and the explicit requirement for the AER to consider whether an alternative decision is materially preferable. See section 7.1.
5. Are there any other issues which impact on the delivery of regulatory decisions that serve the long term interests of consumers?	The timely re-determining of decisions remitted back to the AER has been a key factor in the current 'piling-up' of LMR applications which address the same matters – see section 7.3 and section 8.
6. Are the current grounds for review sufficiently robust to avoid undue weight being placed on minor matters in merits reviews?	Yes – and TransGrid's experience in considering whether to apply for LMR attests to this (see section 2.2).
7. Are there any issues with the scale and scope of material that can be	TransGrid has not covered this in this submission.

	brought forward in relation to reviews?	
8.	Is there a way to minimise the regulatory impost of maintaining a record of decision making as part of any future reforms?	TransGrid has not covered this in this submission.
9.	Are there any barriers to the Tribunal seeking additional expert advice? If so, how could these barriers be addressed?	TransGrid has not covered this in this submission.
10.	Is participation without legal representation possible? Are there barriers hindering full consumer participation in the review process?	TransGrid has no relevant experience on this point.
11.	How costly has your participation in the appeal process been and what are the implications of this participation for you?	TransGrid has no relevant experience on this point.
12.	What are/were your expectations of how the Tribunal would consider the input from consumers?	TransGrid has no relevant experience on this point.
13.	How can parties provide the Tribunal with sufficient evidence to inform its decision making, while still supporting the Tribunal in its aim to conclude decisions within three months?	TransGrid has not covered this in this submission.
14.	What has been the impact of the extended timeframe of review processes? How could these impacts be addressed?	See sections 7 and 8.
15.	What would be the impact of maintaining the current regime?	Maintaining the current LMR regime would enable a body of precedent to be built up, providing greater regulatory certainty and improved decision-making going forward. See section 6.2 and section 7.
16.	What amendments, if any, would you propose to achieve the policy intent of the 2006 and 2013 LMR reforms?	TransGrid considers that further work is required to correctly identify whether the current regime will not meet the policy intent, and that this can only be done once the initial determinations following the 2012 Rule changes have been resolved. See section 3 and section 8.

17. Should the existing Tribunal review process be made more investigatory in nature? If so, how could this be achieved?	Options for reform need to be more carefully identified - see section 8
18. What are the risks of establishing a new review body? Are there any challenges associated with implementing this option?	Options for reform need to be more carefully identified - see section 8
19. Would it be possible to increase the clarity of grounds for review, and their relevance to the long term interests of consumers, by establishing a new body?	Options for reform need to be more carefully identified - see section 8
20. Could a new review body provide an appropriate balance between access to reviews where necessary and ensuring the long term interests of consumers are delivered? How would a new investigatory body help achieve this balance?	Options for reform need to be more carefully identified - see section 8
21. What role and structure could a new review body have? Are there any examples of a sector specific review body that could be applied to energy?	Options for reform need to be more carefully identified - see section 8
22. Do you have any suggestions for how a new investigatory body could be appropriately resourced?	Options for reform need to be more carefully identified - see section 8
23. What are the likely consequences of removing access to merits review of revenue determinations and access arrangements? If access to LMR was removed, are there any complementary changes to the wider regulatory frameworks, or other legislative changes, that might be considered to provide accountability for regulatory decisions and deliver the long term interests of consumers?	The LMR regime is a fundamental pillar of the regulatory framework applying in the energy sector, and hasty or ill-considered reforms have the potential to inflict lasting damaging to the perception of Australia as an investment environment with low sovereign risk. See sections 2, 3, 4 and 7.
24. In circumstances where redress is sought through judicial review	Moving to a system that allows only judicial review would be prohibitive in

	processes, what mechanisms could be put in place to better support consumer and user participation?	terms of meaningful participation by consumer groups and other stakeholders. See section 8.
25.	Should all access to merits review be removed or only for electricity revenue determinations and gas access arrangement decisions?	See section 8
26.	Are there other areas of reform to the broader regulatory framework that would assist in achieving the policy intent of the 2013 reforms to LMR and deliver outcomes in the long term interests of consumers?	See section 8. Options for addressing the reasons the AER has become an apparent 'roadblock' in the LMR process could include (i) a greater degree of prescription in the NER and NGR as to the process and timing for determinations that need to be remade; and (ii) a renewed consideration of the governance and funding arrangements of the AER.

A.2 Timeframe and consultation allowed for previous review of LMR regime

The following table sets out the timeframe under which the previous 2012/13 review of the LMR regime was conducted, highlighting the staged process and multiple opportunities for consultation.

Table 1: Stages and consultation opportunities – Previous review of LMR regime (2012/13)

Consultation/Submission	Date	Submissions accepted
Expert Panel LMR review commenced	7 March 2012	-
Preliminary consultation paper released	30 March 2012	Yes
Target date for receipt of initial views	13 April 2012	-
Consultation paper Two released	27 April 2012	Yes
Interim Stage One report provided to SCER Senior Committee of Officials (SCO)	30 April 2012	Yes
First round consultation – public forum	**9 May 2012**	**-**
Target date for submissions on Stage One issues	1 June 2012	-
Final Stage One report provided to SCER and Panel statement concerning its approach to Stage 2 issues published	30 June 2012	-
Discussion paper three released	July 2012	Yes
Second round consultation – public forum	**30 July 2012**	**-**
Interim Stage Two report provided to SCER SCO	31 August 2012	Yes
Final Stage Two report provided to SCER	30 September 2012 (published 9 October 2012)	Yes
Submissions on recommendations in Final Stage 2 Report due	26 October 2012	-
Consultation Regulatory Impact Statement	14 December 2012	Yes
Decision Regulatory Impact Statement	**June 2013**	**-**

Source: https://scer.govspace.gov.au/workstreams/energy-market-reform/limited-merits-review/lmr-review/

A.3 Merits reviews for Australian jurisdictional regulators

Jurisdiction	Relevant legislation	Merits review
Victoria	*Essential Services Commission Act 2001*	Yes Part 7 of the *Essential Services Commission Act 2001* stipulates that a determination by the ESC can be appealed and, if so occurs, an Appeal Panel (consisting of three members) must be established. The role of the Appeal Panel is to undertake a merits review of the issues raised in the applications.
South Australia	*Essential Services Commission Act 2002 (South Australia)*	Yes Part 6 of the *Essential Services Commission Act 2002 (South Australia)* stipulates that the regulated entity and/or the Minister may request the ESCOSA to undertake a merits review of its price review decision. The regulated entity, or any other party participating in the price review, can appeal the decision (or reviewed decision) to the court for a form of merits review.
Western Australia	The *Gas Pipelines Access (Western Australia) Act 1998,* the *Electricity Networks Access Code 2004* and the *Government of Western Australia's Electricity Industry Act 2004*	Yes In line with the arrangements under the NGL and NGR, the ERA's decisions are subject to Limited Merits Review by the Australian Competition Tribunal (ACT). These arrangements have been in place in Western Australia since 1 January 2010. Prior to that time, the ERA administered the National Third Party Access Code for Natural Gas Pipeline Systems in Western Australia – as subordinate legislation under *the Gas Pipelines Access (Western Australia) Act 1998*. LMR under that process involved review by a State-based Gas Review Board. Western Australia has its own law relating to electricity networks access, which is governed by the *Electricity Networks Access Code 2004* under the Government of *Western Australia's Electricity Industry Act 2004*. These arrangements are also subject to a review process which is similar to the LMR process. Applications for review under the Act are heard by a State-based Electricity Review Board which is constituted when an application for review of a decision is lodged.
Australian Capital Territory	*Independent Competition & Regulatory Commission Act 1997*	Yes Section 24N of the *Independent Competition & Regulatory Commission Act 1997* covers the nature of the review
Northern Territory	*Utilities*	Yes

	Commission Act	Section 28 of the *Utilities Commission Act* allows an appeal to be made on the grounds that: (a) there has been bias; or (b) the facts on which the decision is based have been misinterpreted in a material respect.
Tasmania	*Electricity Supply Industry Act 1995*	Yes Section 96 of the *Electricity Supply Industry Act 1995* allows administrative review to be applied for and for applicants to set out in detail the grounds on which they seek review of the decision
New South Wales	*Independent Pricing and Regulatory Tribunal Act 1992*	No IPART decisions can be subject to a judicial review but not a merits review
Queensland	*Queensland Competition Authority Act 1997*	No QCA decisions can be subject to a judicial review but not a merits review

A.4 Post-2013 reviews

A.4.1 Issues appealed and the Tribunal's findings

The following tables summarises the aspects of the regulators' decisions appealed by each applicant.

NSW/ACT

The following table is for the first eight NSW matters.

Appealed issue	Ausgrid	Essential Energy	Endeavour Energy	ActewAGL (DNSP)	PIAC (Ausgrid)	PIAC (Essential Energy)	PIAC (Endeavour Energy)	JGN	**Error Established**	**Judicial review application**
Return on equity	✓	✓	✓	✓				✓	No	
Return on debt	✓	✓	✓	✓	✓	✓	✓	✓	Yes	AER
Opex - benchmarking	✓	✓	✓	✓	✓	✓	✓		Yes	AER
Opex -other			✓						n/a	
EBSS	✓	✓	✓						No	
Gamma	✓	✓	✓	✓				✓	Yes	AER
STPIS				✓					Yes	
X-factor	✓	✓	✓						n/a	
Metering services	✓								No	
Metering services - opex				✓					n/a	
Metering classification				✓					n/a	

Market expansion capex	✓	Yes

The following table is for the ActewAGL(gas) matter – this matter is yet to be heard.

Appealed issue	ActewAGL (gas)	Error established
Return on debt	✓	
Gamma	✓	
Forecast inflation	✓	

SA

The following table is for the SA matters – these are yet to be heard.

Appealed issue	SA Power Networks	SACOSS	Error established
Return on equity	✓	✓	
Return on debt	✓		
Base year opex		✓	
Gamma	✓		
Forecast inflation	✓		
Forecast labour cost escalation	✓		
Bushfire mitigation capex	✓		
Asset inspections[1]	✓		
No access poles inspections[2]	✓		

Notes: (1) Opex for increased asset inspections in bushfire risk areas; and (2) opex for no access poles inspections.

VIC

The following table is for the VIC matters – these are yet to be heard.

Appealed issue	United Energy	CitiPower	Powercor	Jemena	AusNet	Error established
Return on debt				✓	✓	
Opex - other					✓	
Gamma	✓	✓	✓	✓	✓	
Forecast inflation	✓					
Labour price growth rates		✓	✓			

WA

The following table is for ATCO.

Appealed issue	ATCO	Error established
Return on equity	✓	No
Opex - other	✓	No
Gamma	✓	Yes
Capex	✓	No
Depreciation	✓	No
Reference Tariff Variation Mechanism	✓	No

The following table is for DBNGP – this matter is yet to be heard.

Appealed issue	DBNGP	Error established
Return on equity	✓	
Gamma	✓	
Subsequent costs (non-turbine reactive maintenance)	✓	
Definition of the P1 reference service	✓	